

# SWISS INVESTMENT REPORT\* 19

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The Swiss Investment Report is especially designed for Chinese Investors, who are intending to extend their business to Switzerland or Europe or are already doing business in Switzerland.

The Swiss Investment Report provides background information on the Swiss investment-related legal framework as well as information on current developments in the Swiss legislation from a foreign investor’s perspective.

## Regulatory Treatment of Initial Coin Offerings in Switzerland and China - An Overview

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# Regulatory Treatment of Initial Coin Offerings in Switzerland and China - An Overview

## I. Introduction

With the development of blockchain technology, the initial coin offerings (ICOs) have been increased significantly in both Switzerland and China recently. Relevant authorities in both countries promulgated certain regulations/rules to regulate the ICO activities in their jurisdiction. China considers the ICOs as unauthorized illegal public financing in nature, and the ICOs are suspected of involving in the illegal sales of coins, illegal issuance of securities, illegal fundraising, financial fraud, pyramid sale and other illegal and criminal activities, and therefore the ICOs shall not be circulated and used in the market as currencies. Comparing with the Chinese conservative attitude towards the ICOs, Swiss authorities, even though having possible criminal dangers in mind, recognize the innovative potential of distributed ledger/blockchain technology and generally welcome and support all efforts to develop and implement blockchain solutions in the Swiss financial center. This article briefly introduces the development of regulatory treatment of ICOs in Switzerland and China and provides the ICO organizers with the information to carry out their ICO campaign properly in both countries.

## II. Regulations on Initial Coin Offerings in Switzerland

The Swiss Financial Market Supervisory Authority (FINMA) defines ICOs as a digital form of raising funds from the public. FINMA's mission is to protect investors, creditors and policyholders. It also ensures that the financial markets in Switzerland function properly. Part of its legal mandate is therefore to publish information for individuals, issue public warnings and receive substantiated public complaints about licensees. In accordance with the usual procedure for ICOs, financial backers transfer a certain amount of crypto currency to an address generated by Blockchain provided by those who are organizing the ICO campaign. In return, financial backers receive blockchain-based coins or other tokens associated with a specific project or company operated by the ICO's organizers. However, according to FINMA there is no universal and all-encompassing definition of ICOs.

### 1. Guidance 04/2017

ICOs are currently not subject to any specific regulation, neither globally nor in Switzerland. However, this does not mean that there is a legal vacuum for ICOs. In FINMA Guidance 04/2017,

published on 29 September 2017, FINMA outlined its position on ICOs and identified areas in which ICOs could fall within the scope of existing financial market regulation:

a) Provisions on combating money laundering and terrorist financing

The Anti-Money Laundering Act applies if the issuance of a token by an ICO provider involves the issuance of a payment instrument. If this is the case, other supervisory issues may be effective for third parties, in particular for professional cryptobrokers or trading platforms that perform exchange transactions or transfers of tokens (secondary trading in tokens). Money laundering risks are especially high in a decentralized blockchain-based system, in which assets can be transferred anonymously and without any regulated intermediaries.

b) Banking regulations

Acceptance of public contributions requires the ICO operator to make a commitment to participants, as the ICO usually requires a banking license.

c) Provisions on securities trading

A licensing obligation for the operation as a securities dealer may exist if the issued tokens are valid as securities (e. g. derivatives).

d) Provisions in the Collective Investment Schemes legislation

Possible links with legislation on collective investment schemes may arise if the assets collected under the ICO are managed externally.

Hence, it is very likely that at least one of the abovementioned laws is applicable for any kind of ICO. This also applies to cases where a circumvention of the legal regulations is sought. Due to the diverse structure of the ICO models, FINMA can only make a final regulatory assessment in certain cases. FINMA is currently assessing a number of such cases. Enforcement proceedings are initiated in the event of a violation or circumvention of financial market legislation.

## 2. Guidelines for enquires regarding the regulatory framework for ICOs

In its latest ICO Guidelines published on 16 February 2018, which complement its earlier FINMA Guidance 04/2017, FINMA basically explains how it intends to deal with requests from ICO organizers for the applicability of regulations under current financial market legislation in Switzerland. In addition, the guidelines define the information that FINMA needs in order to deal

with such requests and the principles on which it will base its responses in order to provide clarity for market participants.

In the following, this article intends to give an overview of the most important regulations and findings of the new guideline:

a) Decision on a case-by-case basis

At present, there is no ICO-specific regulation, nor is there relevant case law or consistent legal doctrine. Thus, each case needs to be considered holistically.

b) Token categories

There is no generally accepted classification of ICOs and the resulting tokens, neither in Switzerland nor internationally. FINMA categorizes tokens on the basis of their underlying economic function:

- **Payment tokens:** Payment tokens are equivalent to cryptocurrencies and have no further functions or links to other development projects. In some cases, payment tokens can only develop the necessary functionality and can be accepted as means of payment over a period of time;
- **Utility tokens:** Utility tokens are tokens designed to provide digital access to an application or service using a blockchain-based infrastructure;
- **Asset tokens:** Asset tokens represent assets such as participations in real physical underlyings, companies or revenue streams or a claim to dividends or interest payments. In terms of their economic function, the tokens are analogous to equities, bonds or derivatives.

However, the individual token classifications are not mutually exclusive. Asset and utility tokens can also be classified as payment tokens (called hybrid tokens). In these cases, the requirements are cumulative; in other words, the tokens are both securities and means of payment.

c) Tokens as securities and/or anti-money laundering

Securities regulation is intended to ensure that market participants can base their decisions about investments on a reliable minimum set of information. Furthermore, trading should be fair, reliable and offer efficient price formation.

On the basis of the abovementioned criteria (functionality and transferability), FINMA will process ICO requests as follows:

- **Payment tokens:** For ICOs where the token is to be used as a means of payment and can already be transferred technically on a blockchain infrastructure, FINMA requires compliance with the money laundering regulations. However, FINMA will not treat these tokens as securities;

- **Utility tokens:** These tokens shall only qualify as securities if they are solely for the purpose of granting digital access rights to an application or service, and if the utility token can be used in this way at the time of issuance. If a utility token functions exclusively or partly as an investment in economic terms, FINMA treats such tokens as securities (i. e. in the same way as asset tokens). Anti-money laundering regulation is not applicable as long as the main reason for issuing the tokens is to provide access rights to a non-financial application of blockchain technology;

- **Asset tokens:** FINMA regards asset tokens as securities, which means that trading in such tokens is subject to the provisions of securities law and the civil law requirements of the Swiss Code of Obligations (e. g. prospectus requirements).

In conclusion, FINMA distinguishes between payment, utility and asset tokens and clarifies that hybrid forms are possible. From a regulatory point of view, FINMA again points out that inter alia the anti-money laundering and securities regulations could be relevant. FINMA further clarifies that each project must be decided on its individual merits.

In this context, FINMA will hold a series of round tables in March and April 2018 in Zug, Geneva and Lugano to explain its assessment of ICOs in accordance with FINMA's ICO Guidelines, the categorization of tokens and the possible influence of financial market regulation on ICOs. The aim is to provide interested market participants with first-hand information and facilitate a direct exchange between stakeholders and FINMA. Moreover, following further consolidation of its supervisory practice, FINMA may in the future decide to publish its interpretation in the form of a circular.

### III. Regulations on ICOs in China

#### 1. Nature of ICOs

On 9 April 2017, The People's Bank of China, the Office of the Central Leading Group for Cyberspace Affairs, the Ministry of Industry and Information Technology, the State Administration for Industry and Commerce, the China Banking Regulatory Commission, the China Securities Regulatory Commission and the China Insurance Regulatory Commission (hereinafter "Chinese Authorities") issued an announcement on Preventing the Financing Risks of ICOs ("Announcement"). The mission

of the Announcement is, as the Chinese authorities preached, purporting to protect investor's rights and interests and preventing and alleviating financial risks. Chinese authorities define ICOs financing as "the financing operators' raising of Bitcoin, Ethereum and other so-called 'virtual currencies' from investors through illegal public financing, and is suspect of involving in the illegal sales of tokens, illegal insurance of securities, illegal fundraising, financial fraud, pyramid sale and other illegal and criminal activities". The tokens or "virtual currencies" used in the ICOs financing are not issued by competent authorities, do not have money attributes such as legal compensation and compulsory nature, have no equal legal status with currencies, and thus should not be circulated and used in the market as currencies.

Chinese authorities also alert publicly the potential risks of ICOs, which includes the risk of false assets, the risk of business failure and the risk of investment and speculation etc.

#### 2. No organization or individual may illegally conduct ICO financing activities

All kinds of ICO financing activities shall immediately be ceased from the date of issuance of the Announcement. The organizations and individuals that have completed ICO financing shall withdraw and make other arrangements. Relevant authorities shall undertake investigation and punish ICO financing activities in accordance with law.

#### 3. Token financing trading platforms are prohibited to exchange legal currencies with tokens and virtual currencies

The token financing trading platforms are prohibited to exchange legal currencies with tokens and "virtual currencies". They shall not trade tokens or provide agency service related to tokens, such as pricing, information intermediary etc. For those violating aforesaid rules, the website platform and mobile APP will be subject to closure and removal. The business licences of such platforms may be revoked.

#### 4. No financial institutions and non-banking payment institutions shall conduct business relating to ICOs

All financial institutions and non-banking payment institutions shall refrain from, directly or indirectly, providing account opening, registration, trading, liquidation, settlement and other products or services for ICOs. They shall not carry out insurance business relating to tokens and "virtual currencies".

## 5. Self-discipline role of industry organization

The Chinese financial industry association is obliged to urge its members to voluntarily resist illegal financing activities relating to ICOs.

As a conclusion, as a new development worldwide based on blockchain technology, ICOs are not welcomed by the Chinese government. On the contrary, Chinese authorities not only define ICOs as illegal financial activities but also prohibit all the market participants' financial activities related to ICOs in all aspects. This conservative attitude will inevitably have a bad influence on the market participants related to ICOs and will probably hinder the development of such technology and economy in China in the future.

## **IV. Conclusion**

The development of ICOs is a fruit of new blockchain technology. Against this new development, China prohibits the financial activities related to ICOs completely in all aspects, which eventually kills the possibilities to operate any ICOs in China. Switzerland, however, welcomes and supports all efforts to develop and implement ICOs. By categorising tokens into payment tokens, utility tokens and asset tokens, FINMA provides market participants with guidance on the applicability of laws. This will help the ICO market participants to better comply with Swiss regulations and thus improve the healthy development of ICOs in Switzerland.

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